

386.454 Fiduciary's election to have certain standards apply to administration of trust or estate -- Power to adjust between principal and income -- Conversion to unitrust -- Powers under previous version of section.

- (1) (a) A fiduciary may, after providing notice as required under paragraph (g) of this subsection, adjust between principal and income to the extent the fiduciary considers necessary, the terms of the trust or will describe the amount that may or shall be distributed to a beneficiary by referring to the trust's or estate's income, and the fiduciary determines, after applying the rules in KRS 386.452(1), that the fiduciary is unable to comply with KRS 386.452(2). Additionally, a fiduciary may reserve the right to convert the trust to a unitrust under subsection (2) of this section in the future.
- (b) In deciding whether and to what extent to exercise the power conferred by this subsection, a fiduciary shall consider all factors relevant to the trust or estate and its beneficiaries, including the following factors to the extent they are relevant:
 1. The nature, purpose, and expected duration of the trust or estate;
 2. The intent of the settlor or testator;
 3. The identity and circumstances of the beneficiaries;
 4. The needs for liquidity, regularity of income, and preservation and appreciation of capital;
 5. The assets held in the trust or estate and:
 - a. The extent to which they consist of financial assets, interests in closely held enterprises, tangible and intangible personal property, or real property;
 - b. The extent to which an asset is used by a beneficiary; and
 - c. Whether an asset was purchased by the fiduciary or received from the settlor or testator;
 6. The net amount allocated to income under the other sections in this chapter and the increase or decrease in the value of the principal assets, which the fiduciary may estimate as to assets for which market values are not readily available;
 7. Whether and to what extent the terms of the trust or will give the fiduciary the power to invade principal or accumulate income or prohibit the fiduciary from invading principal or accumulating income, and the extent to which the fiduciary has exercised a power from time to time to invade principal or accumulate income;
 8. The actual and anticipated effect of economic conditions and market volatility on principal and income and effects of inflation and deflation; and
 9. The anticipated tax consequences of an adjustment.
- (c) A fiduciary shall not make an adjustment:
 1. That diminishes the income interest in a trust that requires all of the

income to be paid at least annually to a spouse and for which an estate tax or gift tax marital deduction would be allowed, in whole or in part, if the fiduciary did not have the power to make the adjustment;

2. That reduces the actuarial value of the income interest in a trust to which a person transfers property with the intent to qualify for a gift tax exclusion;
 3. That changes the amount payable to the beneficiary as a fixed annuity or a fixed fraction of the value of the trust assets;
 4. From any amount that is permanently set aside for charitable purposes under a will or the terms of a trust unless both income and principal are so set aside;
 5. If possessing or exercising the power to make an adjustment causes an individual to be treated as the owner of all or part of the trust or estate for income tax purposes, and the individual would not be treated as the owner if the fiduciary did not possess the power to make an adjustment;
 6. If possessing or exercising the power to make an adjustment causes all or part of the trust or estate assets to be included for estate tax purposes in the estate of an individual who has the power to remove a fiduciary or appoint a fiduciary, or both, and the assets would not be included in the estate of the individual if the fiduciary did not possess the power to make an adjustment;
 7. If the fiduciary is a beneficiary of the trust or estate; or
 8. If the fiduciary is not a beneficiary, but the adjustment would benefit the fiduciary directly or indirectly; except that any effect on the fiduciary's compensation shall not preclude an adjustment so long as the fiduciary's fees are reasonable and otherwise comply with the applicable law.
- (d) If paragraph (c)5., 6., 7., or 8. of this subsection applies to a fiduciary and there is more than one (1) fiduciary or an additional fiduciary who is appointed by court order, a binding agreement, or otherwise as provided by law, a co-fiduciary to whom the provision does not apply may make an adjustment unless the exercise of the power by the remaining fiduciary or fiduciaries is not permitted by the terms of the trust or will. If paragraph (c)5., 6., 7., or 8. of this subsection restricts all fiduciaries from possessing or exercising a power under this section, the fiduciary may petition the District Court for the court to effect the intended conversion or action.
- (e) A fiduciary may release the entire power conferred by this subsection or may release only the power to adjust from income to principal or the power to adjust from principal to income if the fiduciary is uncertain about whether possessing or exercising the power will cause a result described in paragraph (c)1. to 6. of this subsection or if the fiduciary determines that possessing or exercising the power will or may deprive the trust or estate of a tax benefit or impose a tax burden not described in paragraph (c) of this subsection. The release may be permanent or for a specified period, including a period

measured by the life of an individual. Further, a fiduciary may divide a trust or estate into one (1) or more fractional shares if the division does not change the beneficial interests.

- (f) Terms of a trust or will that limit the power of a fiduciary to make an adjustment between principal and income do not affect the application of this section unless it is clear from the terms of the trust or will that the terms are intended to deny the fiduciary the power of adjustment conferred by this subsection.
- (g) A fiduciary shall not make an election or adjustment under this section unless all of the following apply:
 - 1. A fiduciary shall give written notice of the fiduciary's intention to make an adjustment to each beneficiary, by certified mail with restricted delivery and return receipt, who, on the date the notice is given:
 - a. Is a distributee or permissible distributee of trust income or principal; or
 - b. Would be a distributee or permissible distributee of principal if the interests of the distributees described in subparagraph 1.a. of this paragraph terminated and the trust then terminated immediately before the notice was given and if no powers of appointment were exercised;
 - 2. There is at least one (1) beneficiary under subparagraph 1.a. of this paragraph and at least one (1) other reasonably ascertainable person who is a remainder beneficiary under subparagraph 1.b. of this paragraph; and
 - 3. Every beneficiary to whom notice was sent pursuant to subparagraph 1. of this paragraph has received the notice as evidenced by the certified mail return receipt and no beneficiary objects to the adjustment or election in writing delivered to the fiduciary within thirty (30) days after the notice is given under subparagraph 1. of this paragraph.
- (h) The fiduciary may petition the District Court under this subsection to order an adjustment or an election if any of the following apply:
 - 1. A beneficiary timely objects to the adjustment or the election, or a beneficiary has not received the notice as evidenced by the certified mail return receipt;
 - 2. There is no reasonably ascertainable beneficiary under paragraph (g)1.a. of this subsection; or
 - 3. There is no reasonably ascertainable beneficiary under paragraph (g)1.b. of this subsection.
- (2) The following rules shall govern a fiduciary's conversion of a trust to a unitrust:
 - (a) Unless expressly prohibited by the terms of a trust, a fiduciary may release the power to make adjustments under subsection (1) of this section and convert to a unitrust as described in this subsection, if all of the following apply:

1. The fiduciary determines that the conversion will enable the fiduciary better to carry out the intent of the settlor or testator and the purposes of the trust;
 2. The fiduciary gives written notice of the fiduciary's intention to release the power to adjust and to convert the trust into a unitrust and of how the unitrust will operate, including what initial decisions the fiduciary will make under this subsection, to each beneficiary, by certified mail with restricted delivery and return receipt, who, on the date the notice is given:
 - a. Is a distributee or permissible distributee of trust income or principal; or
 - b. Would be a distributee or permissible distributee of trust principal if the interests of the distributees described in subparagraph 2.a. of this paragraph terminated and the trust then terminated immediately before the notice was given and if no powers of appointment were exercised;
 3. There is at least one (1) beneficiary under subparagraph 2.a. of this paragraph and at least one (1) other reasonably ascertainable person who is a remainder beneficiary under subparagraph 2.b. of this paragraph; and
 4. Every beneficiary to whom notice was sent pursuant to subparagraph 2. of this paragraph has received the notice as evidenced by the certified mail return receipt and no beneficiary objects to the conversion to a unitrust in a writing delivered to the fiduciary within thirty (30) days after the notice is given under subparagraph 2. of this paragraph;
- (b) The fiduciary may petition the District Court under this subsection to order a conversion to a unitrust if any of the following apply:
1. A party timely objects to the conversion to a unitrust, or a beneficiary has not received the notice as evidenced by the certified mail return receipt;
 2. There is no reasonably ascertainable beneficiary under paragraph (a)2.a. of this subsection; or
 3. There is no reasonably ascertainable beneficiary under paragraph (a)2.b. of this subsection;
- (c) Notwithstanding the provisions of paragraph (h) of this subsection, a beneficiary may request a fiduciary to convert to a unitrust. If the fiduciary does not convert, the beneficiary may petition the District Court to order the conversion. The court shall approve the conversion or direct the requested conversion if the court concludes that the conversion will enable the fiduciary to better carry out the intent of the settlor or testator and the purposes of the trust;
- (d) In deciding whether to exercise a power to convert to a unitrust under this section, a fiduciary may consider, among other things, the factors set forth in

subsection (1)(b) of this section;

- (e) After a trust is converted to a unitrust, all of the following provisions shall apply:
1. The fiduciary shall follow an investment policy seeking a total return for the investments held by the trust, whether the return is to be derived:
 - a. From appreciation of principal;
 - b. From earnings and distributions from principal; or
 - c. From both;
 2. The fiduciary shall make regular distributions in accordance with the terms of the trust, or the terms of the will, as the case may be, construed in accordance with the provisions of this section; and
 3. Unless expressly prohibited by the terms of the trust, the term "income" in the terms of a trust or will means an annual distribution, the "unitrust distribution," equal to the percentage, the "payout percentage," that is no less than three percent (3%) and no more than five percent (5%) and that the fiduciary may determine in the fiduciary's discretion from time to time, or, if the fiduciary makes no determination, that shall be four percent (4%), of the net fair market value of the trust's assets, whether such assets would be considered income or principal under other provisions of this chapter, averaged over the lesser of:
 - a. The three (3) preceding years; or
 - b. The period which the trust has been in existence;
- (f) The fiduciary may in the fiduciary's discretion from time to time determine all of the following:
1. The effective date of a conversion to a unitrust;
 2. The provisions for prorating a unitrust distribution for a short year in which a beneficiary's right to payments commences or ceases;
 3. The frequency of unitrust distributions during the year;
 4. The effect of other payments from or contributions to the trust on the trust's valuation;
 5. Whether to value the trust's assets annually or more frequently;
 6. What valuation dates to use;
 7. How frequently to value nonliquid assets and whether to estimate their value;
 8. Whether to omit from the calculations trust property occupied or possessed by a beneficiary; and
 9. Any other matters necessary for the proper functioning of the unitrust;
- (g) The following provisions regarding unitrust distribution shall apply:
1. Expenses which would be deducted from income if the trust were not a unitrust shall not be deducted from the unitrust distribution;
 2. Unless otherwise provided by the terms of the trust, the unitrust

distribution shall be paid from net income, as such term would be determined if the trust were not a unitrust. To the extent net income is insufficient, the unitrust distribution shall be paid from the net realized short-term capital gains. To the extent net income and net realized short-term capital gains are insufficient, the unitrust distribution shall be paid from net realized long-term capital gains. To the extent net income and net realized short-term and long-term capital gains are insufficient, the unitrust distribution shall be paid from the principal of the trust; and

3. To the extent necessary to cause gains from the sale or exchange of unitrust assets to be treated as income under any federal, state, or local income tax, such as section 643 of the Internal Revenue Code and its regulations, including Treasury Regulation sec. 1.643(b)-1, as amended or renumbered, the fiduciary has the discretionary power to allocate the gains to income, so long as the power is reasonably and impartially exercised;
- (h) Notwithstanding any other provision of this section to the contrary, a fiduciary or beneficiary may petition the District Court:
1. To change the payout percentage;
 2. To provide for a distribution of net income, as would be determined if the trust were not a unitrust, in excess of the unitrust distribution if such distribution is necessary to preserve a tax benefit;
 3. To average the valuation of the trust's net assets over a period other than three (3) years; and
 4. To reconvert from a unitrust to the preconversion terms of the trust;
- (i) Upon a reconversion, the power to adjust under subsection (1) of this section shall be revived, and a trustee shall not be precluded from seeking a later unitrust conversion;
- (j) A conversion to a unitrust does not affect a provision in the terms of a trust directing or authorizing the fiduciary to distribute principal or authorizing a beneficiary to withdraw a portion or all of the principal of the trust;
- (k) A fiduciary shall not possess or exercise any power under this subsection in any of the following circumstances:
1. The unitrust distribution would be made from any amount that is permanently set aside for charitable purposes under the terms of a trust and for which a charitable deduction from a federal gift or estate tax has been taken unless both income and principal are so set aside;
 2. The possession or exercise of the power would cause an individual to be treated as the owner of all or part of the trust for federal income tax purposes and the individual would not be treated as the owner if the fiduciary did not possess or exercise the power;
 3. The possession or exercise of the power would cause all or any part of the trust estate to be subject to any federal gift or estate tax with respect to the individual and the trust estate would not be subject to such

taxation if the fiduciary did not possess or exercise the power;

4. The possession or exercise of the power would result in the disallowance of a federal gift or estate tax marital deduction which would be allowed if the fiduciary did not have the power; or
 5. The fiduciary is a beneficiary of the trust;
- (l) If paragraph (k)2., 3., or 5. of this subsection applies to a fiduciary and there is more than one (1) fiduciary or an additional fiduciary who is appointed by a court order, binding agreement, or otherwise as provided by law, a co-fiduciary to whom paragraph (k)2., 3., or 5. of this subsection does not apply may possess and exercise the power unless the possession or exercise of the power by the remaining fiduciary or fiduciaries is not permitted by the terms of the trust or will. If paragraph (k)2., 3., or 5. of this subsection restricts all fiduciaries from possessing or exercising a power under this section, the fiduciary may petition the District Court for the court to effect the intended conversion or action; and
- (m) A fiduciary may release any power conferred by this section if any of the following applies:
1. The fiduciary is uncertain about whether possessing or exercising the power will cause a result described in paragraph (k)2., 3., or 5. of this subsection; or
 2. The fiduciary determines that possessing or exercising the power will or may deprive the trust of a tax benefit or impose a tax burden not described in paragraph (k) of this subsection.

The release may be permanent or for a specified period, including a period measured by the life of an individual.

- (3) Unless a beneficiary has requested the fiduciary in writing that the fiduciary consider an adjustment, unitrust conversion, or change in payout percentage, nothing in this section imposes a duty on the fiduciary to make an adjustment, conversion, or change in payout percentage under subsection (2)(e)3. of this section, and the fiduciary is not liable for not considering whether to make an adjustment, conversion, or change in payout percentage under this section.
- (4) This section is intended to further describe and clarify the powers previously granted under the immediately preceding version of this section. These clarifications and revisions shall apply to and be available for all applicable and qualifying trusts, including any trust which may have previously sought relief under a prior version of this section.

Effective: July 15, 2014

History: Amended 2014 Ky. Acts ch. 25, sec. 106, effective July 15, 2014. -- Amended 2012 Ky. Acts ch. 59, sec. 2, effective July 12, 2012. -- Amended 2010 Ky. Acts ch. 21, sec. 6, effective July 15, 2010. -- Created 2004 Ky. Acts ch. 158, sec. 3, effective January 1, 2005.

Legislative Research Commission Note (7/12/2012). In subsection (2)(a) of this statute, a reference to "paragraph (f)" has been changed to read "paragraph (g)." In subsection (3)(d) of this statute, a reference to "paragraph (a) of subsection (2) of this

section" has been changed to read "subsection (2)(b) of this section." These corrections are clearly required by the context and by examination of changes in paragraph designations that were adopted in successive drafts of 2012 Ky. Acts ch. 59, sec. 2. The Reviser of Statutes has corrected these manifest clerical or technical errors under KRS 7.136(1).

Legislative Research Commission Note (7/12/2006). 2006 Ky. Acts ch. 247 instructs the Reviser of Statutes to adjust KRS references throughout the statutes to conform with the 2006 renumbering of the Financial Services Code, KRS Chapter 286. Such an adjustment has been made in this statute.

Legislative Research Commission Note (1/1/2005). In 2004 Ky. Acts ch. 158, sec. 3, subsec. (2), a reference is made to "subsection (1) of this Act." Because it is clear from the subject matter of ch. 158, sec. 3, subsec. (1), that the reference was intended to be to "subsection (1) of this section" instead, this manifest clerical or typographical error has been corrected during codification by the Reviser of Statutes under KRS 7.136(1).